

Client Alert

From the
Corporate, Securities
and Tax Group

March 2003

This Client Alert provides information of general interest. Information is presented in summary form and should not be construed as individual legal advice. Professional rules in some jurisdictions may treat the Client Alert as advertising.

Reproduction with attribution permitted.

GOLDBERG KOHN BELL BLACK ROSENBLUM & MORITZ, LTD
TEL 312.201.4000 FAX 312.332.2196 WEBWWW.GOLDBERGMORITZ.COM
55 EAST MONROE STREET SUITE 3700 CHICAGO ILLINOIS 60603-5802

 MERITAS LAW FIRMS WORLDWIDE

Asset Protection: Hype or Help?

BACKGROUND

Skyrocketing insurance rates. Staggering tort judgments. Punitive damages. More and bigger bankruptcies. Every business owner, executive, and affluent individual faces increased risks to the assets he or she has painstakingly accumulated. A single lawsuit (perhaps of doubtful merit) may wipe out everything. For some activities where lawsuits are plentiful – certain medical specialties, for example – realistic levels of insurance coverage are simply unavailable. Thus, it's no surprise that people of means are investigating techniques to put their assets beyond the easy reach of creditors.

Many asset protection mechanisms are available, ranging from time-tested techniques to stratagems of dubious validity. What is appropriate for one person, facing specific risks, domiciled in a particular State, with a unique family situation, can be totally wrong for someone else. To help cut through the hype and identify the key considerations, Barbara M. Flom, a principal in our Corporate, Securities and Tax Group, collaborated with the Private Client Group of Wells Fargo Bank, N.A. to facilitate a "Topic Forum" on asset protection strategies at the University Club of Chicago on January 30, 2003.

While the Topic Forum format made possible a wide-ranging, free-form discussion of situations, techniques, anecdotes and recommendations, the following outline distills the basic questions that anyone should ask who is considering taking steps to protect his or her assets.

KEY QUESTIONS TO CONSIDER

Who?

- Professionals at risk of huge malpractice judgments
- Business owners (especially in injury-prone or environmentally sensitive industries)
- Executives of struggling businesses

When?

- Before a lawsuit is filed against you
- While you're still solvent
- At a time when you would remain solvent even if you made a large gift
- When you're willing to incur the cost and inconvenience of living with asset protection structures
- When you are comfortable that you have trustworthy family members or fiduciaries

What (structures)?

- Concurrent ownership (joint tenancy, tenancy by entirety)
 - o *Not* tenancy in common; creditors can force partition

KEY QUESTIONS TO CONSIDER, continued

- Maximizing value in “exempt” assets not reachable by creditors
 - Homestead, qualified retirement plans, insurance, personal assets
- Limited liability companies (LLCs) or limited partnerships to hold business operations, investments
 - Creditors’ remedy, a charging order, is very limited (thus unattractive to creditors)
 - Also useful for estate planning, lifetime transfers
- Trusts
 - Insurance trusts
 - Qualified personal residence trusts (also used for tax planning)
 - Self-settled irrevocable spendthrift trusts (in Alaska, Delaware, Nevada – or offshore)
 - Inheritance spendthrift trusts (for professional children of wealth)
- NOTE: State laws differ widely, and differences affect utility of techniques in individual cases

Where (onshore vs. offshore)?

- Offshore structures make it harder for creditors to seize assets
 - But if you’re onshore, you can still be sued here
 - In a few cases, U.S. courts have jailed debtors for contempt for not turning over (or disclosing) offshore assets, even in situations where it was not entirely clear that the debtors could have forced the turnover
 - Offshore structures are more costly to set up and maintain
 - You have to be willing to follow your assets offshore, if necessary
- Some onshore structures are untested in the courts – and ultimately may not work
 - A few States permit self-settled spendthrift trusts – the rest consider them “against public policy”
 - U.S. Constitution “full faith and credit” clause requires a State to honor another State’s judgments
 - What will happen when a creditor gets a judgment in a majority-rule State and goes to enforce it against a trust in a minority-rule State?
 - Eventually, the law will reach a balance between debtors’ and creditors’ rights... but that will take years to sort out
 - Meanwhile, you can’t be sure your self-settled trust will be respected

Why?

- You’re in a business where unavoidable lawsuits could bankrupt you
- You’re comfortable:
 - giving up control over transferred assets;
 - not being free to unwind the structures once put in place;
 - that your family members or fiduciaries will use the transferred assets to take care of you, if necessary; and
 - with the cost, inconvenience and complexity of:
 - setting up the asset protection mechanisms; and your financial life thereafter

Why not (i.e., what *won’t* asset protection achieve)?

- It does not exempt you from paying U.S. taxes
 - If you make “completed gifts,” you may escape future income tax on the transferred property... at the cost of incurring current gift tax (or using your “unified credit” against gift and estate taxes)
- It doesn’t prevent anyone from suing you
 - If your professional reputation or license is on the line, you may still want to defend these lawsuits... and incur legal fees to do so

Why Not, continued

- It's not a substitute for carrying appropriate amounts of insurance
- It may already be too late to protect your assets
 - Once a claim is made, a suit is filed, or a judgment is rendered against you, you cannot move your assets beyond the reach of creditors
 - Transfers for less than "fair value" when you are insolvent, or that would leave you insolvent, are "fraudulent conveyances" which a court can set aside

CONCLUSION

Asset protection is achievable and may be appropriate, but is never simple and should not be undertaken lightly. Persons who face high levels of risk, as well as those who are especially risk-averse, should consider seeking the advice of counsel to explore whether any of these asset protection strategies could appropriately be implemented as part of their overall business and financial plan.

If you would like to discuss asset protection strategies with Barbara Flom, or with any of the other principal attorneys in the Corporate, Securities and Tax Group, please contact:

Dennis B. Black • (312) 201-3916 • dennis.black@goldbergkohn.com

Denise B. Caplan • (312) 201-3901 • denise.caplan@goldbergkohn.com

Gerald L. Jenkins • (312) 201-3902 • gerald.jenkins@goldbergkohn.com

William R. Loesch • (312) 201-3969 • william.loesch@goldbergkohn.com

Alice G. Owings • (312) 201-3990 • alice.owings@goldbergkohn.com

GOLDBERG KOHN BELL BLACK ROSENBLUM & MORITZ, LTD

TEL 312.201.4000 FAX 312.332.2196 WEB WWW.GOLDBERGMORITZ.COM

55 EAST MONROE STREET SUITE 3700 CHICAGO ILLINOIS 60603-5802

 MERITAS LAW FIRMS WORLDWIDE

Goldberg Kohn is a 75-attorney commercial law firm located in downtown Chicago with principal concentrations in Real Estate, Labor and Employment, Litigation, Bankruptcy and Creditors' Rights, Corporate, Securities & Tax, Intellectual Property, Class Action Defense and Commercial Finance. For more information regarding our practice areas, please visit our web site at www.goldbergkohn.com.

© Goldberg Kohn 2003